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UNCLAS SECTION 01 OF 06 SAO PAULO 000436

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STATE FOR WHA/BSC, WHA/EPSC, WHA/PDA, EB/MTA
STATE PASS USTR FOR AUSTR EISSENSTAT AND SULLIVAN/LEZNY
H PASS SENATORS GRASSLEY, CRAPO, ALLARD
H ALSO PASS REPS KING, ENGLISH, CARNAHAN, PETERSON, ISSA
NSC FOR CRONIN
TREASURY FOR OASIA, DAS LEE AND FPARODI
USDOC FOR 4332/ITA/MAC/WH/OLAC/JANDERSEN/ADRISCOLL/MWAR D
USDOC ALSO FOR 3134/USFCS/OIO/SHUPKA
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SUBJECT: CODEL GRASSLEY: FRANK DISCUSSIONS ON TRADE IN SAO PAULO

A) SAO PAULO 360; B) SAO PAULO 352; C) BRASILIA 628

¶1. (SBU) SUMMARY: During its recent visit to Sao Paulo, CODEL Grassley engaged in vigorous and sometimes contentious discussions with representatives of Brazil's private sector over U.S. and Brazilian trade policies and different approaches to bilateral and multilateral trade negotiations. Brazil's most powerful industrial association, which officially supports free trade but has many protectionist members, urged greater leadership from the United States in international trade negotiations and a more generous US offer to reduce agricultural subsidies. The Sao Paulo business sector in general wants closer ties to the U.S., is frustrated with the Lula administration's excessive focus on South-South trade at the expense of expanding trade with the U.S. and other developed countries, and overwhelmingly supports (in private) opposition presidential candidate Geraldo Alckmin over the reelection of President Lula. The visit offered an excellent opportunity for the CODEL to hear directly from important private sector leaders on a number of issues, as well as to expose the Brazilians to the perspective of key members of the U.S. Congress. END SUMMARY.

¶2. (U) Senator Charles Grassley (IA) - Chairman of the Senate Finance Committee - and his delegation visited Maringa, Parana state and Sao Paulo, March 22-23. Other members of the delegation included Senators Mike Crapo (ID) and Wayne Allard (CO); Representatives Collin Peterson (MN), Phil English (PA), Steve King (IA), Darrell Issa (CA), and Russ Carnahan (MO); and, Assistant U.S. Trade Representative for the Americas Everett Eissenstat. In Maringa the delegation toured a sugar mill and ethanol plant. In Sao Paulo, it met with the leadership of the Federation of Industries of Sao Paulo State (FIESP) and the American Chamber of Commerce (AMCHAM), and visited a General Motors facility where

members learned about the manufacture and operation of flex-fuel automobiles. They also received a briefing on Brazilian agriculture from a representative of the industry-funded think tank Institute for International Trade Negotiations (ICON). This cable addresses the trade aspects of the CodeL visit. The ethanol and FlexFuel-engine automobile aspects, and Rep. Issa's separate meeting with the Brazilian-Lebanese community, were reported in refs A-B.

Very Frank Discussion on Trade with FIESP

¶3. (SBU) During a discussion that was unusually frank, representatives of the Federation of Industries of Sao Paulo State (FIESP) used their time with CODEL Grassley mostly to lecture the Members of Congress and their staff on the pitfalls of current U.S. tactics and positions regarding multilateral and bilateral trade negotiations. Using a very Brazilian modus operandi, FIESP speakers acknowledged the importance of Brazil's trade relationship with the United States, while trying hard to appear fiercely independent - but not belligerent - with respect to USG positions.

¶4. (SBU) In an encouraging introduction to an open and frank discussion of business issues between U.S. lawmakers and leaders of Brazil's industrial sectors, FIESP President Paulo Skaf noted the historic ties between the United States and Brazil, and his country's love of such things American as music and technology. He reviewed highlights of Brazilian trade statistics and the basics of trade relations between Brazil and the United States, noting that the United States remains Brazil's number one single-country trading partner.

¶5. (SBU) Skaf then turned the microphone over to his chief economic

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and trade advisor, former Ambassador to the United States Rubens Barbosa, who challenged the U.S. lawmakers regarding U.S. trade positions on agriculture and implored the United States to take a leadership role to revive the stalled WTO Doha Round and FTAA negotiations. He began by suggesting that the FTAA should not be considered failed. Barbosa said a sound framework for the FTAA is already in place due to Brazilian and U.S. leadership, and that with a commitment to the process by our two leader nations, negotiations need only be restarted in order to move the agreement forward. He noted that he often needed to remind GOB representatives that 68 percent of imports to the United States face no tariffs, and he proudly pointed out that Brazilian (applied) tariff have fallen in recent years from an average of 55 percent to the current 11 percent average. Barbosa then went on to describe how key Brazilian sectors were affected by trade restrictions, and both he and several of the other FIESP panelists said the United States is in the best position to jump-start the FTAA negotiations by offering concessions, particularly in the area of agricultural supports. He said "balanced negotiations" were needed, and FIESP leaders also accused the United States of abandoning multilateral trade agreements in favor of bilateral agreements that hold little value in terms of creating free trade and building regional relations.

Brazil Wants to Be Both Developed and Developing

¶6. (SBU) In his response, Sen. Grassley led the Members in suggesting the Brazilians were disingenuous by touting their country's strong export figures but insisting that the United States is in the best position to offer concessions in order to facilitate multilateral trade pacts. The Members noted that Brazil wants to be seen as a developed nation when it comes to negotiations regarding agricultural exports, but simultaneously as a developing nation when it comes to reducing its own tariffs on goods and services. One Member said that dozens of small developing countries with nothing to gain are "lining up" to negotiate free trade agreements with the United States simply for the prestige of it, and that given Brazil's desire to be a leading regional and global player, it should be more willing to make serious concessions if it really wants WTO and FTAA negotiations to resume in substance.

¶7. (SBU) Chairman Grassley pointed to continued reductions in agricultural supports, as evidenced by Congress's recent budget proposals, as proof that the United States remains committed to Doha and FTAA. Refuting the charge that the United States has abandoned the multilateral arena in favor of bilateral trade agreements, Chairman Grassley said that while the United States also prefers multilateral agreements, given the logjams in both the Doha Round and FTAA negotiations, the United States will continue to negotiate bilaterally wherever it can in order to continue facilitating free trade in general.

Plea to Eliminate US Tariffs on Ethanol Imports

¶8. (SBU) Focusing on the popular issue of ethanol production, Roberto Giannetti da Fonseca, Managing Director of FIESP's International Affairs and Trade Department, pointed out that Brazil and the United States are the world's leaders in ethanol production, and together cannot meet the world's demand. He noted that Brazilian producers recently met with California Governor Arnold Schwarzenegger to discuss the use of Brazilian ethanol as an additive to gasoline. Fonseca suggested Brazil and the United States could use ethanol as a development tool, exporting technology and know-how to Africa, for example, so countries there could use

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cassava as a means of producing fuel. Fonseca closed on a familiar theme, calling on the Members of Congress to eliminate the current U.S. tariff on ethanol imports as a means of ensuring free trade in the product. Ref B provides fuller discussions of the CODEL's discussions on the ethanol issue.

"Brazil Cost" Makes Brazilian Industry Less Competitive

¶9. (SBU) On a less policy-oriented and more practical note, Mario Marconini, a FIESP industrial sector consultant, offered that most industrialists in Brazil were adamant free traders, but pointed to the high cost of doing business in Brazil as a key factor inhibiting true competitiveness for the country. He lamented that Brazil's businesses find themselves with an overall tax rate comparable to that of Western Europe but without the corresponding benefits of good infrastructure and government services. Thus, he said, even if a WTO agreement is reached, Brazil will face significant trade challenges from its competitors.

An Agriculture-Heavy List of Complaints

¶10. (SBU) A document distributed during the meeting entitled "Statement by FIESP Regarding US-Brazil Relations" echoed the themes raised in discussion, acknowledging the importance of the relationship, lamenting the lack of an agenda, urging US leadership, and complaining about FTAs the US is signing in the region. The document also listed a number of trade concerns about which FIESP seeks US Congressional support, including:

- Generalized System of Preferences: 15 percent of Brazilian exports to the US benefit from GSP and Brazil wants to maintain that benefit.
- Intellectual Property: FIESP supports rigorous IPR enforcement in Brazil.
- Aircraft Sales: Embraer should be allowed to sell 36 military aircraft to Venezuela, a sale blocked by the USG.
- Services: The US has many restrictions at state and federal levels (such as citizenship and residency requirements) to the practice of professional services such as law, engineering, and architecture.
- Double Taxation Agreement: Needed with increasing number of Brazilian firms investing in the US, such as Embraer (aircraft), Gerdau (steel), and Cutrale (orange juice).
- Ethanol Subsidies: Reduction of US subsidies for ethanol (13 percent corn production subsidy, 13.5 cents credit per liter of ethanol produced, import tariff of 13.8 cents per liter) will enable Brazil to become a strategic partner to help the US' energy policy.
- Soybean Subsidies: Brazil has considered challenging the US in

the WTO over the USD 1.5-3.2 billion in subsidies annually.

-- Anti-Dumping: 15 of the 278 anti-dumping measures in place in the United States are against Brazil (orange juice, shrimp, and steel), with the perception they exist for protectionist purposes. Constraints faced by Brazilian producers (e.g., high taxes and interest rates) hinder the adoption of sustained artificially low prices.

-- Market Access: Although the US economy is open, there are key markets in which Brazil is competitive that are restricted by quotas (sugar, tobacco, beef), tariff peaks (footwear and textiles and clothing), and sanitary barriers (chicken and beef).

-- WTO Panel Compliance: The US "has not complied" with the cotton case deadline, and Brazil is considering requesting another WTO panel because, while two offending subsidy programs have been eliminated, certain other programs remain unchanged. The Byrd

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Amendment "should have been ended" in 2005, but will only be ended in Jan. 2007; Brazil has the right to retaliate but has chosen not to do so.

Comment: Behind FIESP's Positions

111. (SBU) FIESP is Brazil's most powerful industrial federation encompassing 122 industrial sectors and thousands of businesses. The current leadership under President Paulo Skaf, a textile manufacturer with political ambitions who campaigned for the job promising a closer relationship with the Lula administration, is pro-free trade, despite the protectionist tendencies of many of its members. Industrial leaders have confided to us that Brazil does indeed have a handful of competitive industries that could withstand a reduction of import tariffs that would be negotiated in the Doha Round. FIESP's seemingly excessive advocacy of agriculture, an area largely outside its membership, could well be hiding behind the skirts of knotty agricultural issues to protect its inefficient sectoral members as long as possible. At the same time, FIESP may simply be taking an inherently Brazilian stand on trade issues it believes are in the country's national interest. While FIESP has tried to come closer to the current GOB, it has been frustrated by a series of GOB decisions that are diametrically opposed to FIESP's interests, such as the decision to grant market economy recognition to China.

112. (SBU) Comment Continued: It is no secret that the overwhelming majority of business people in Sao Paulo support opposition presidential candidate Geraldo Alckmin.

Regarding Amb. Barbosa, who heads FIESP's economic council but does not have a direct leadership position in the federation itself, it seems Skaf wanted someone of Barbosa's experience and prestige in international trade matters. However, Barbosa is strong-willed and retains a certain compulsion to defend MFA policies, as he had to do as ambassador to the US, even if his organization does not necessarily agree with everything he says. In fact, a senior FIESP leader confided to us well after the Codel meeting that Barbosa had gone too far and did not accurately reflect FIESP's official views.

END COMMENT.

Breakfast at AMCHAM - Trade Negotiations

113. (SBU) Senator Grassley led off the cordial but spirited breakfast meeting at AMCHAM by describing the purpose of the CODEL's visit. The group wanted to encourage AMCHAM to continue its dialogue with the GoB; learn more about the similarities between the two countries in the agricultural sector, particularly in its approaches to ethanol and addressing energy crises; and seek ways to move forward with WTO Doha Round negotiations. This last issue was particularly critical because the President's Trade Promotion Authority (TPA) is due to expire in July 2007; thus it is incumbent on Brazil and the United States to move forward quickly on trade negotiations. Senator Grassley said he supports renewing TPA, but there is resistance in Congress to liberalizing trade, as demonstrated by the difficulty in ratifying the Central American/Dominican Republic Free Trade Agreement (CAFTA/DR).

¶14. (SBU) AMCHAM Board Member Joseph Tutundjian (Chairman of International Negotiations Task Force) said AMCHAM sees itself as "lobbying" on behalf of both USG and U.S. private sector interests, but is looking for more good-faith measures from U.S. to make its task easier. At the same time, AMCHAM does not agree with the GoB's

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FTAA negotiating strategy. Members of the delegation noted that the U.S. cannot make more substantive concessions on agriculture without a comprehensive agreement. At the same time, the U.S.-Brazil Caucus in the House is working to create awareness of the issues and promote mutual interests.

¶15. (SBU) The AMCHAM leaders noted that in trade negotiations involving Brazil, private actors and industry representatives do not have the prominent role their counterparts did in other free trade agreement (FTA) negotiations such as NAFTA. The Brazilian private sector has been excluded from the debate on agriculture, which was not the case in the NAFTA talks. The lack of strong private-sector input has impeded progress. They also argued that the U.S. pursuit of bilateral FTAs in Latin America is viewed as a threat and a means of isolating Brazil. Senator Grassley rejoined that a comprehensive WTO or FTAA agreement is needed to help establish rule of law and facilitate private initiatives. It is Brazil that is isolating itself through the deadlocks in WTO and FTAA negotiations with its intransigent negotiating position. Despite the debacle at the September 2003 Cancun WTO Ministerial, some progress was made at December 2005 Hong Kong WTO Ministerial.

¶16. (SBU) AMCHAM members acknowledged that both the U.S. and Brazil recognize that the EU is the greatest impediment to reducing subsidies and resolving the agricultural disputes that have stymied WTO negotiations. Both countries share an interest in persuading the EU to make greater concessions. However, Brazil sees the EU as less of an obstacle than the U.S., because the EU imports far more agricultural products than the U.S. does. Senator Grassley and other members of the delegation noted that agriculture is a particularly difficult issue because it is a strategic pillar for all parties. Grassley reiterated that the U.S. cannot make more substantive concessions on agriculture without a comprehensive agreement. The 2002 Farm Bill, which contains many agricultural subsidies, remains in effect and will not be dismantled without such an agreement. Congress would need grounds to replace it, such as greater access to the Brazilian market in manufacturing and services.

Roundtable on Agriculture

¶17. (U) Later in the day, CODEL Grassley attended a 45-minute presentation and discussion on agricultural trade negotiations. Scheduled speakers were Marcos Sawaya Jank, President of ICONE, a think tank that advises Brazilian industry and government on trade policy matters, and Joao Sampaio, President of the Brazilian Rural Society (SRB), the Brazilian equivalent of the American Farm Bureau.

In this event, Sampaio deferred to Jank and indicated that Jank was advocating SRB's position as well.

¶18. (SBU) Jank gave a presentation outlining Brazilian views on agriculture in the WTO. He stressed that Brazil and the U.S. have areas of significant common interest, especially on market access, export competition, and sanitary/phytosanitary and genetically modified organism (GMO) issues. Jank pointed out that we have significant divergence of interests on the issue of agricultural supports, and began a detailed examination of agricultural supports for selected U.S. products. Jank's critique of U.S. policy provoked a spirited exchange with several of the delegation members, principally with Senator Grassley and Representatives Issa and Peterson. The CODEL members clearly stated that Brazilian flexibility on access for goods and services is inadequate, and its willingness to fight for market access for agriculture was likewise

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inadequate in light of Brazil's fixation on American agricultural support levels. (Comment: Jank is a longstanding Consulate contact who is one of Brazil's most knowledgeable and articulate experts on agricultural trade issues. He has been critical of the current GOB's trade negotiating strategy and could end up in some influential GOB position should opposition candidate Geraldo Alckmin win the October presidential elections. That said, he also reflects the broadly supported Brazilian position that the U.S. needs to offer even more substantial cuts in agricultural subsidies if the Doha Round is to have any chance of success. End Comment).

Comment

¶19. (SBU) This visit provided members of the delegation with exposure to Brazilian views on trade issues, especially in the area of agriculture. At the same time, it gave some of our key Brazilian private-sector interlocutors a chance to hear what the trade negotiations look like from the perspective of key members of the U.S. Congress. The fact that real differences of opinion were aired in several of the meetings, and that the debates were at times pointed and even heated, is a healthy sign. Overall, the Sao Paulo business sector wants closer trade relations with the U.S. and is critical of the Lula administration's foreign policy of focusing on South-South relations. We will continue to work toward closer cooperation on trade and other issues with FIESP, AMCHAM and other business organizations. End Comment.

¶20. (U) This cable was coordinated/cleared with Embassy Brasilia.

MCMULLEN